

United States House of Representatives Committee on Financial Services

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2128 Rayburn Office Building**

Auction Rate Securities Market: A Review of Problems and Potential Resolutions

Testimony by

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Chairman Miller and Frank, Representative Shea Porter, Representative Hodes and Members of the Committees:

For the record, I am Tara Payne, a resident of New Hampshire, and the Vice President for Corporate Communications representing the New Hampshire Higher Education Loan Corporation (NHHELCO). The NHHEAF Network Organizations are comprised of four 501(c) (3) nonprofit organizations that provide students and families with the resources and funding to pursue higher education aspirations. Funds generated by the Organizations make their charitable mission possible as student loan earnings are reinvested in programs and services that benefit citizens of New Hampshire.

It is an honor to participate in these discussions.

I must first publicly thank the Representatives from New Hampshire who continue to be strong advocates for student access to higher education.

I have been asked to describe NHHELCO's experience with the auction rate securities market and how the break-down of that market has affected NHHELCO's ability to provide student loans.

Background and Scope

For more than 43 years, the Federal Family Education Loan Program (FFELP) has reliably provided over \$735 billion in loans to students and their parents. Thousands of schools and millions of students and their parents rely on FFELP providers, like NHHELCO, to meet their tuition and other postsecondary costs. In our capacity as a nonprofit guarantor, lender and servicer for student loans, we take great pride in educating students about responsible borrowing. Consequently, we consistently have among the lowest cohort default rates in the nation. The cohort default rate measures the percentage of borrowers who enter repayment on their loan in a given federal fiscal year and default on their loans by the end of the following fiscal year.

Having a low cohort default rate means that NHHELCO's commitment to provide excellent loan counseling, support services and borrower benefits has had a very positive impact on our loan borrowers. When students successfully repay their federal education loans, everyone benefits: taxpayers don't have to shoulder the

burden of increased federal debt to cover loan losses; schools maintain their eligibility to award federal financial aid; and best of all, students realize the full benefit of the investment they have made in higher education.

The FFELP community is dedicated to promoting college access, particularly for under-served students and adults, and it does so by offering free career, college and financial aid information and advising and by organizing an extensive array of early awareness/outreach programs for students. The impact of these college access programs is enormous and widespread. Consider that in New Hampshire alone, 95% of public high schools rely heavily on the services we provide and 34,000 students and parents attend our educational school and community-based college awareness programs and workshops. We tailor specific programs to local needs and requirements such as through our Students Transitioning and Achieving Results program to New Hampshire foster youth. We created and administer a local scholarship database and provide professional development training to school counselors and teachers. Our highest priority has been to develop positive collaborative relationships with the local K-12 school systems.

And I must stress the importance of having agencies such as ours across the nation providing these services to all students and schools, regardless of which student loan program they ultimately use, and that they are services not provided by the direct loan program.

Still, the traditional and long-standing methods to fund student loans, combined with the financial impact of the Deficit Reduction Act and College Cost Reduction and Access Act, have resulted in 134 lenders suspending or terminating their participation in FFELP. One of the unintended consequences of the legislative cut to subsidies for nonprofit lenders and the current liquidity crisis is the risk of losing programs like the Center for College Planning in New Hampshire.

Access to college begins with increasing aspirations but it ultimately ends with availability of financial aid programs and funding options.

We are proud of the integrity and commitment we have made to these programs, but in this year, fulfilling our most essential mission has been extremely challenging.

NHHELCO is New Hampshire's leading provider of student loan financing and funded \$184 million in federal loans and \$67 million in alternative loans in FY07. In total, NHHELCO has \$1,482,500,000 in outstanding bonds which has funded our programs since 1997.

NHHELCO's Experience with Auction Rate Securities

The \$330-billion auction rate market has been important as the key source of liquidity for student loan lenders. For the last decade, NHHELCO borrowed money to fund loans by selling auction rate certificates. However, investors no longer are investing in the auction rate market. Thus, issuers can't raise capital to fund loans. Most investors were advised that ARS would be safe; a vehicle with no risk or loss of principal and 100 percent liquid. From what we have now all learned, they were generally sold by advisors as "cash equivalents".

The FFEL program is highly regulated. Still, regulations aside, our organization has always held itself to a high standard of financial accountability. We recognize that we bear responsibility to ensure that whatever taxpayer money is spent on our program is minimal and that access to higher education is made possible through our sustaining a strong financial base.

This strong financial base has been significantly compromised by NHHELCO's long-standing trusted financial advisor, UBS Securities, LLC. UBS was the underwriter, selling broker-dealer and marketer of NHHELCO's student loan auction rate securities. UBS also acted as an advisor to NHHELCO. In fact, the bankers at UBS have been NHHELCO's financial advisor and broker-dealer since 1997.

On August 14, 2008, the New Hampshire Bureau of Securities Regulation, announced that it was taking action against UBS Securities, LLC for fraud. The action relates to UBS' representation of NHHELCO in the sale of bonds used to finance loans to New Hampshire college students and their parents.

Essentially, the cease-and-desist order issued by the Bureau states that UBS knew that the market for these bonds was on the verge of collapse. At the same time, UBS was actively encouraging NHHELCO to extend its commitment to these bonds. UBS advised NHHELCO to reset the maximum rate on NHHELCO's taxable bonds to 17% to 18% to ensure liquidity and prevent auctions from failing. We know now that this was a "scheme" to make the securities more attractive to investors and to keep NHHELCO in the Student Loan Auction Rate Securities (SARS) market. UBS never disclosed to NHHELCO that the SARS market was at risk of freezing and that the maximum interest rate payable on the NHHELCO bonds could lead to NHHELCO's financial harm or that UBS was preparing to ends its support of the market.

Until mid-February 2008, UBS supported prices by bidding for bonds that went unsold, preventing auctions they ran from failing. At the same time, UBS was actively considering withdrawing its own holdings in the market while advising NHHELCO to stay in. On February 13, 2008, UBS stopped supporting the SARS market and it collapsed, leaving NHHELCO and investors with billions of dollars frozen. UBS had an obligation to provide NHHELCO with all available information about market conditions and to look out for NHHELCO's best interests in order that NHHELCO could fulfill its important mission. It is absolutely clear that UBS did not do so, putting its interests ahead of its long-standing client.

UBS never did approach NHHELCO with any creative solutions to the funding crisis while they were apparently transitioning some SARS issuers to other types of debt structure including variable rate demand obligations ("VRDOs"). The costs, beyond the fees, and the consequences for other areas of our business, were the increased maximum rate that reduced NHHELCO's assets from \$64 million in September 2007 to \$18.6 million in July, 2008.

We support the NH Bureau of Securities Administration in its assertion that UBS' actions constituted fraud and that UBS failed in its fiduciary and moral duty to NHHELCO.

IMPACT of the ARS Market Breakdown

Federal loans are enough for many college students. In New Hampshire, where state support for higher education is among the lowest in the nation and tuition and fees are among the highest, alternative loans are a key factor in affordability and access. The amounts students can borrow through the Federal Stafford loan program are capped and fall far short of the typical tuition bill. For example, \$5,500 is available for a dependent college freshman—and many families turn to private loans to make up the difference.

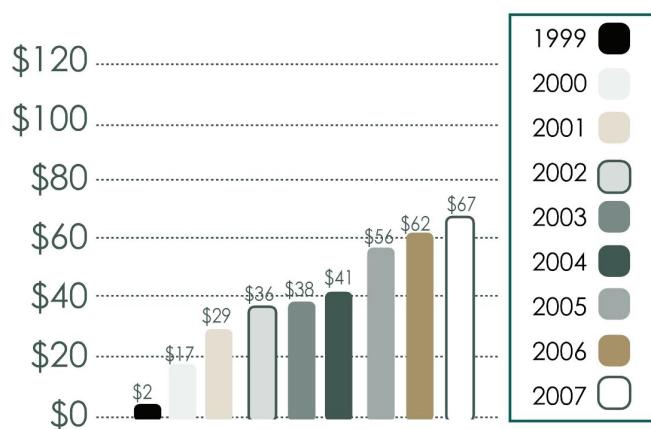
NHHELCO's non-federal alternative loan program, Loan for Education Assistance Funding (LEAF), provided funding to close the gap between what students receive in financial aid (including federal student loans such as Stafford or Perkins) and what the college actually costs. We have provided over \$431 million to fund almost 64,000 alternative loans to NH students since 1993.

In FY07, 6,130 students borrowed \$67 million through our alternative loan program.

Still, recognizing the severity of the liquidity crisis, the reduction to lenders such as NHHELCO from recent legislation, and the lack of viable solutions from our financial advisors, NHHELCO was forced to suspend its alternative student loan program in March leaving thousands of students to search for other alternatives.

This action was taken in order to focus available resources on funding federal student and parent loans, the most basic point of access. Our major concern is that college-prepared students are being "priced out" of college. We know from the Pell Institute that high-income youth are six times more likely to earn a four-year degree than are low-income youth, and the gap between them has nearly doubled in the last 35 years.¹ The more complex and more costly the private loan market becomes, that more the education gap will increase. Consider that for NHHELCO alone, there was a 76% growth in private loans in over just eight years. Today, students rely on private loan dollars to fund their educations.

Net Loan Volume for Private Loans 1999 - 2007



Thus, it is NHHELCO's hope that the Bureau's actions will lead to meaningful relief for the students who have depended on NHHELCO as their affordable source of student loan financing for many years.

Current Liquidity

Loan Data from Mark Kantrowitz on the finiad.org site reveals that:

Thirty-three lenders have suspended private student loans. A total of 134 lenders have suspended federal programs. These totals include 16 nonprofit state loan agencies. Four state loan agencies (PHEAA, MEFA, MHESLA and Brazos) have suspended all FFELP originations. Every type of lender has been affected: 16 state loan agencies, 62 banks, 18 credit unions, 4 non-profit lenders, 3 school-as-lender schools (with 45 more coming soon) and 35 non-bank lenders.

Loan Program	FY2006	FY2007
Stafford and PLUS Loans <u>(including</u> School-as-Lender schools)	15.9% \$7.9 billion > 940,000 borrowers 34 of the Top 100	16.0% \$9.1 billion > 970,000 borrowers 37 of Top 100

Any interruption in the loan program hurts college-bound students. It causes a disruption in financial aid delivery and creates another layer of complexity to a tedious financial aid process. Naturally, it would have the greatest impact on the most vulnerable students. We were fortunate that a creative *temporary* solution was arrived at even *without* the assistance of our financial advisor, which enabled us to continue to remain in FFELP.

NHHELCO appealed to community lenders in hopes that they would continue to see a critical need to support the student loan program for NH students. In March, 2008, NHHELCO asked the member institutions of the NH Bankers Association and NH credit unions to assist by providing liquidity that would enable NHHELCO to provide New Hampshire students and parents with the necessary financing for college. There was great urgency in the request as families and colleges needed immediate assurance of the availability of funds. It is truly remarkable to see the commitment of our community lenders. Currently, \$94 million has been raised. I can assure you that NHHELCO would have suspended its federal program if it were not for the overwhelming support of community lenders.

Ultimately, Federal loans became safeguarded through July 2009 thanks to Congress' swift passage of the Ensuring Continued Access to Student Loans Act and the Department of Education's development and implementation of loan participation and loan sale programs for lenders.

The Participation Agreements will allow New Hampshire students and students nationwide to get their federal loans. This action protects federal fiscal interest without providing taxpayer burden as the program is cost-neutral. However, there is still no sign that credit markets will soon return to normal and that adequate future liquidity will be available. By the time Congress reconvenes, students and families will be well along the way to making decisions regarding their education and training plans for the 2009-10 academic year. The continuing uncertainty in the credit markets has stalled any improvement in the availability of private-sector capital to support the delivery of needed financial aid to students and families next year through the FFEL Program.

Therefore, as a member of the National Council on Higher Education Loan Programs, NHHECO will be advocating for an extension of the current 14-month program to at least July 1, 2010.

(In New Hampshire we know that eighty-two percent of borrowers in repayment believe that the opportunity to go to college would not have been possible without access to student loans.¹ The credit crisis has threatened many families' ability to get a second mortgage or for students to qualify for private education loans without parents as co-signers. As a result, some low and middle income families may be running out of college funding options. We understand that some are turning to borrowing from 401k plans and putting tuition on credit cards. Alarmingly, 28% of respondents reported used a credit card to pay for tuition costs. Since students often do not have a steady source of income or are employed in low-wage jobs, establishing a pattern of paying even the minimum payments on a consistent basis may not yet be a priority for these borrowers who have had little education in personal financial matters. In an analysis of current college students, we found that 28% of freshmen had over \$3,000 in credit card debt and 51% of freshmen have been reported delinquent on their credit card payments.²)

Our nation's young adults and their parents need assurance that funding is within reach.

Thank you for your time and attention.

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¹ FinAid Page, LLC. Mark Kantrowitz, Publisher of www.FinAid.org

² Beyond Access: College Success for Low-Income, First-Generation Students, Jennifer Engle, The Pell Institute

³ Borrowing for a Brighter Future: Perspectives on Financing College, 2008, The NHHEAF Network Organizations

⁴ Clothed, Fed and Over Their Heads: Credit Card Use of NH Student Loan Borrowers, 2008, The NHHEAF Network Organizations